

27 August, 2001

Treasurer

DEBT/EQUITY BILL: AMENDMENTS

Timing: Wednesday 5 Sept, for amendments to be introduced in the week of 17 Sept.

Recommendation: That you approve amendments (to be moved in the Senate) to the New Business Taxation System (Debt and Equity) Bill 2001 as set out below and sign the attached letter to the Prime Minister seeking his approval. (Agreed/Not Agreed)

Option (b) Attachment B is simpler

...../...../2001

KEY POINTS *means status quo & keeps the focus of the Bill on defining the difference between debt & equity*

- Industry has requested making amendments to improve the Debt/Equity Bill. The transitional period, the non-arm's length rule, treatment of Co-operative Capital Units (CCUs) and the Commissioner's discretionary powers are the most sensitive. *4/9/1*

Section 22

- A number of technical amendments are recommended – see Attachment D.

Section 22

Pages 2-9 section 22

Issue	Recommended Approach
Section 22	
<p>Deductibility of returns on debt interests (section 25-85): This section seeks to ensure that a return on a debt interest is deductible under the general deduction provision (section 8-1) notwithstanding that the return may represent an application of profits (ie, a dividend). Issues raised include:</p> <ul style="list-style-type: none"> • the drafting of section 25-85 may not achieve this policy objective; and • the banks have expressed concern that there is a risk that spreads may widen in the future with the result they are subject to 150 basis points cap in this provision. 	<p>We accept that amendments are required to ensure that section 25-85 achieves the policy objective. The drafting of this section is a delicate issue because of case law dealing with the reasons for the non deductibility of dividends.</p> <p>We recommend against increasing the cap to (say) 200 basis points. The reason for the cap is to prevent a company distributing its profits as deductible payments in lieu of frankable dividends by making the distribution in respect of a hybrid instrument that has been artificially characterised as debt. It is a revenue safeguard measure. We do not envisage a situation where an instrument issued by a bank would ever be caught by this cap given the public nature of their transactions, and if such a situation ever arose in the future there is a regulation making power to vary the cap.</p>
<p>Non-share distributions (section 26-26): This section indicated that returns on non-share equity interests are non-deductible. There is some doubt whether returns on shares (dividends) maybe deductible under the general deduction provision other than in the circumstances provided in the Bill.</p>	<p>For avoidance of doubt, we recommend that a provision be inserted indicating that returns on shares (dividends) are not deductible unless the tax law specifically provides for a deduction.</p>

Section 22

